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## **Iraq: Recent Developments in Reconstruction Assistance**

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# Iraq: Recent Developments in Reconstruction Assistance

## Summary

Large-scale reconstruction assistance programs are being undertaken by the United States following the war with Iraq. To fund such programs, in April 2003, Congress approved a \$2.48 billion Iraq Relief and Reconstruction Fund (IRRF) in the FY2003 Supplemental Appropriation. In November 2003, the FY2004 Supplemental Appropriation provided an additional \$18.4 billion for the IRRF. The FY2005 Emergency Supplemental signed into law in May 2005 provides \$5.7 billion in a new Iraqi Security Forces Fund for the training and equipping of Iraqi security forces.

Contributions pledged at the October 24, 2003 Madrid donor conference by other donors amounted to roughly \$3.6 billion in grant aid and as much as \$13.3 billion in possible loans.

On June 28, 2004, the entity implementing assistance programs, the Coalition Provisional Authority (CPA), dissolved, and sovereignty was returned to Iraq. U.N. Security Council Resolution 1546 of June 8, 2004, returned control of assets held in the Development Fund for Iraq to the government of Iraq. U.S. assistance is now provided through the U.S. embassy.

Many reconstruction efforts on the ground are underway, but security concerns have slowed progress considerably. Of the nearly \$29 billion in appropriated funds from all accounts directed at reconstruction purposes, close to 40% is targeted at infrastructure projects — roads, sanitation, electric power, oil production, etc. About 38% is used to train and equip Iraqi security forces. A range of programs — accounting for roughly 22% of appropriations — are in place to offer expert advice to the Iraqi government, establish business centers, rehabilitate schools and health clinics, provide school books and vaccinations, etc. Of the \$21 billion appropriated to the Iraq Relief and Reconstruction Fund in the FY2003 and 2004 supplementals, \$17.7 billion had been obligated and \$12.5 billion spent by end-December 2005.

The report will be updated as events warrant. For discussion of the Iraq political situation, see CRS Report RL31339, *Iraq: U.S. Regime Change Efforts and Post-Saddam Governance*, by Kenneth Katzman.

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# Iraq: Recent Developments in Reconstruction Assistance

Following years of authoritarian rule and economic sanctions, the United States and the international community agreed in the spring of 2003 that efforts should be made to introduce economic reform and democratic government to post-war Iraq. More recently, the Bush Administration has asserted a “victory” strategy composed of eight objectives, five of which are to: transition Iraq to security self-reliance, help Iraqis form a national compact for democratic government, help Iraq build government capacity and provide essential services, help Iraq strengthen its economy, and help Iraq strengthen the rule of law and promote civil rights.<sup>1</sup>

To meet these ends, a large-scale reconstruction assistance program has been undertaken by the United States in Iraq. This report describes recent developments in this assistance effort.<sup>2</sup>

## Funding for Reconstruction

The best available estimates of the eventual cost of Iraq reconstruction were provided in an October 2003 World Bank and U.N. Development Group needs assessment of 14 sectors of the Iraqi government and economy. Prepared for the benefit of the international donors conference held in Madrid on October 23-24, 2003, it established the targets by which the adequacy of available resources continues to be judged. The World Bank/U.N. assessments put the cost of reconstruction for the 14 sectors at \$36 billion over four years, a figure that does not include \$19.4 billion estimated by the Coalition Provisional Authority (CPA) in 2003 for security, oil, and other sectors not covered by the Bank/U.N. assessments. Combined World Bank and CPA projected reconstruction costs through 2007 amount to \$55 billion.<sup>3</sup> These totals, calculated in mid-2003, did not take into account the significant costs of instability and security needs.

Several potential “spigots” are available to fund Iraq reconstruction. U.S. foreign aid appropriations for Iraq were provided mostly in FY2003, FY2004, and FY2005 emergency supplemental bills. International donors have also made aid contributions. Iraqi funds, largely derived from oil export profits, have been

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<sup>1</sup> National Security Council, *National Strategy for Victory in Iraq*, November 2005.

<sup>2</sup> For detailed discussion of the Iraq political situation, see CRS Report RL31339, *Iraq: U.S. Regime Change Efforts and Post-Saddam Governance*, by Kenneth Katzman.

<sup>3</sup> For the full text of the report online, see the World Bank website at [<http://siteresources.worldbank.org/INTIRAQ/Overview/20147568/Joint%20Needs%20Assessment.pdf>].

employed to cover the “normal” operating costs of the Iraqi government, and, when sufficient amounts are available, have been used to address reconstruction needs. Additionally, the reduction or rescheduling of Iraqi debt repayments makes further resources available. These sources of reconstruction funding are discussed below.

**Table 1. U.S. Appropriations for Iraq Reconstruction**  
(\$ millions)

Appropriations	FY2003	FY2004	FY2005	FY2006	Total
<b>Iraq Relief and Reconstruction Fund</b>	<b>2,475.0</b> (of which 2,473.3 obligated 1/5/05)	<b>18,439.0</b> (of which 15,263.8 obligated 12/28/05)	—	—	<b>20,914.0</b>
Economic Support Fund (ESF)	—	—	—	61.0	61.0
DOD - Iraq Security Forces Fund	—	—	5,700.0 (of which 1,134.4 obligated 10/2/05)	—	5,700.0
DOD - Oil Repair	802.0	—	—	—	802.0
DOD - Iraq Army	51.2	—	—	—	51.2
DOD - CERP	—	140.0	718.0	— *	858.0
Other Agency Funds	477.9	—	—	—	477.9
<b>Total U.S. Reconstruction Assistance</b>	<b>3,806.1</b>	<b>18,579.0</b>	<b>6,418.0</b>	<b>61.0</b>	<b>28,864.1</b>

\*H.R. 2863, FY2006 DOD appropriations allows up to \$500 million for CERP.

**Sources:** Section 2207 Report to Congress Pursuant to P.L. 108-106, October 2005; CPA Inspector General, Report to Congress, Pursuant to P.L. 108-106, October 30, 2005; Department of State, Iraq Weekly Status Report, December 28, 2005; and CRS calculations.

## U.S. Assistance

To date, the bulk of U.S. reconstruction assistance has been provided to a special Iraq Relief and Reconstruction Fund (IRRF) for the purpose of aid efforts in a wide range of sectors, including water and sanitation, food, electricity, training and equipping of Iraqi security forces, education, and rule of law. It was established in the FY2003 Emergency Supplemental (P.L. 108-11, H.R. 1559/H.Rept. 108-76), signed on April 16, 2003, with an appropriation of \$2.5 billion. A subsequent FY2004 Emergency Supplemental (P.L. 108-106, H.R. 3289/H.Rept. 108-337), signed on November 6, 2003, added \$18.4 billion to the IRRF. The Fund was placed under the control of the President.

While the first appropriation had been used to support a broad range of humanitarian and reconstruction efforts, the FY2004 appropriation was largely

intended to have an immediate impact on the two greatest reconstruction concerns raised since the occupation of Iraq began — security and infrastructure. The reconstruction funds were provided entirely as grants, after the Administration threatened to veto any measure that provided aid in the form of loans. The FY2004 legislation established an Inspector General office to monitor the use of funds by the CPA and included extensive reporting requirements regarding expenditures, projects, and other sources of revenue.

In addition to the IRRF, funds have been drawn from other accounts for related purposes. Department of Defense appropriations were used to cover the FY2003 operational expenses of the CPA and have gone to pay part of the costs for repair of Iraq's oil infrastructure, for training of the Iraqi army, and toward the Commanders Emergency Response Program (CERP). In addition to drawing from the IRRF, USAID has used its own funds to pay for humanitarian programs in Iraq.

The FY2005 emergency supplemental (P.L. 109-13, H.R. 1268/H.Rept.109-72), signed on May 11, 2005, provides \$5.7 billion for a new DOD account — the Iraq Security Forces Fund — supporting the training and equipping of Iraqi security forces. Previously, most security training funds have been provided out of the IRRF. Policy responsibility for the IRRF, originally held by the White House and delegated to the CPA (under DOD authority), has, since the end of the occupation in June 2004, belonged to the State Department as a result of a Presidential directive (NSPD 36, May 11, 2004). Putting funding for security entirely under DOD would be a sharp departure from historic practice. Under most military assistance programs — Foreign Military Financing, International Military Education and Training Program, the training of the Afghan army — State makes broad policy and DOD implements the programs. The conference report on the supplemental adopts the President's formula for the new account but requires that the Iraq Security Forces Fund be made available “with the concurrence of the Secretary of State.”

**FY2006 Foreign Operations Appropriations.** In another departure from previous practice, the Administration requested \$414 million in Iraq reconstruction funds under traditional foreign aid accounts in the regular FY2006 foreign operations budget instead of funneling requests exclusively through emergency supplementals and for the IRRF. Of this amount, \$360 million was from the Economic Support Fund (ESF) account and was expected to be used for traditional development programs supporting local governance (\$85 million), civil society (\$30 million), elections (\$15 million), private sector development (\$90 million), economic reform (\$90 million), and agriculture (\$50 million). Another \$26.5 million was requested under the International Narcotics and Law Enforcement (INCLE) account for activities in the justice and rule of law sectors and \$27 million under the Nonproliferation, Anti-terrorism, Demining, and Related Programs (NADR) account for anti-terrorism training. Many of these assistance activities are currently funded out of the IRRF.

In response, on June 28, the House approved H.R. 3057 (H.Rept. 109-152), eliminating the Administration's Iraq requests, on the grounds that sufficient funds — at the time, nearly \$5 billion — remained unobligated and available through the IRRF. The House bill allowed the Administration to use the IRRF for the purposes outlined in the request. The Senate version of the FY2006 State/Foreign Operations

appropriations (S.Rept. 109-96), approved July 20, did not earmark, but allowed the Administration sufficient funds to meet its requests for Iraq. The conference report on the FY2006 Foreign Operations appropriations bill (P.L. 109-102) provides only \$61 million of ESF funds for Iraq — \$5 million for the Marla Ruzicka Iraqi War Victims Fund and \$28 million each for the democratization activities of the International Republican Institute and the National Democratic Institute. The statement of managers specifically rejects the nonproliferation request for Iraq, suggesting that funds be taken from previous year appropriations.

**Will Additional U.S. Funds Be Requested?** Although a news report suggests that no request for reconstruction funds will occur in the February FY2007 budget and quotes a U.S. official as saying that U.S. funding was only meant to “jump-start” the Iraqi economy, there are many reasons to believe that some additional U.S. funding will be considered in the near future, possibly in another emergency supplemental.<sup>4</sup> For one, nearly 85% of total IRRF reconstruction funding has been obligated. Secondly, the SIGIR Inspector General has indicated that, with higher security costs and infrastructure project cost overruns, a “reconstruction gap” has developed that will prevent the United States from being able to fully fund the non-security projects it originally promised to accomplish. In addition, oil production problems and continuing high Iraqi government operating costs mean that the Iraqis will not be able to fund many reconstruction efforts using their own resources, and, although the IMF, World Bank, and Japan have at last moved forward with the sizeable loan offers made in 2003, it is not at all clear that non-U.S. donor assistance will be able to cover gaps in reconstruction needs. Finally, the IRRF calculation above does not include the \$5.7 billion Iraq Security Forces Fund appropriated in Spring 2005, and DOD is reportedly seeking a further \$3.9 billion for Iraqi security forces training and equipping. This, with a larger request for U.S. troops, may provide an inviting legislative vehicle for non-security aid as well.<sup>5</sup>

## Oil Resources

Oil revenues have been a critical element in reconstruction funding. Prior to the war, the Administration had expected that Iraq’s oil reserves would help it “shoulder much of the burden for [its] own reconstruction.”<sup>6</sup> The May 22, 2003, U.N. Resolution 1483 which ended sanctions permitted the occupying coalition to use oil reserves for more long-term reconstruction purposes. The resolution shifted responsibility for oil profits and their disbursement from the U.N. to the United States and its allies by establishing a Development Fund for Iraq (DFI) held by the Central Bank of Iraq and into which oil profits and other Iraqi assets would be deposited.

During the occupation, DFI funds available to the CPA — \$20.7 billion by June 28, 2004 — were used to support a wide range of reconstruction activities, including the currency exchange program, oil and electricity infrastructure repair, purchase of

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<sup>4</sup> “U.S. Has End in Sight on Iraq Rebuilding,” *Washington Post*, January 2, 2006.

<sup>5</sup> “Bush to Outline Broad Iraq Plan,” *New York Times*, November 30, 2006.

<sup>6</sup> Press briefing by Ari Fleisher, White House, February 18, 2003; *Sec. 1506 Report to Congress*, July 14, 2003, p. 4.



firefighting equipment, the Iraqi operating budget, and the Oil for Food Program's monthly food baskets, responsibility for which was transferred from the U.N. to the CPA on November 22, 2003.<sup>7</sup>

Under Security Council Resolution 1546, adopted on June 8, 2004, the transitional government of sovereign Iraq obtained control over use of DFI funds.<sup>8</sup> Oil production accounts for more than 90% of the Iraqi government revenue. Even with the rise in oil prices in 2005, that revenue was still expected to be \$6 billion less than the amount needed to cover anticipated expenditures in the FY2005 Iraqi government budget of \$28 billion.<sup>9</sup>

Recognizing the importance of oil revenue to Iraq reconstruction, more than \$2.5 billion of total U.S. reconstruction funding has been devoted to efforts to restore and expand oil production infrastructure. Oil exporting resumed in mid-June 2003, but oil production has been slowed by sabotage. In September 2004, rates of production reached a peak of 2.67 million barrels/day compared with an estimated pre-war rate of 2.5 million barrels/day, but rates have fallen since then and, as of end-December 2005, stand at 2.0 million barrels/day. The target had been 2.8-3.0 million barrels/day by end of 2004. The Iraqi government says it hopes to raise production to at least 2.5 million barrels/day in 2006.<sup>10</sup>

After paying for operating budget expenses and a variety of government social programs, very little of Iraq's oil revenue has been left for reconstruction. Fuel and food subsidies as well as support for state-owned enterprises are said to account for as much as \$11 billion annually. Because these practices divert funds from needed reconstruction for which the United States might have to compensate, Administration officials have repeatedly pressured the Iraqi transition government to face the need to address the subsidy issue. As part of its agreement with the IMF pursuant to a debt

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<sup>7</sup> Since the end of the occupation, the SIGIR *estimates* another \$26.5 billion, mostly oil revenues, has been added to the DFI. It pays for Iraqi government programs. SIGIR, *Report to Congress*, October 30, 2005, p. D-4.

<sup>8</sup> Other Iraqi assets are also expected to be put in the DFI. On March 20, 2003, President Bush issued an executive order confiscating non-diplomatic Iraqi assets held in the United States. Of the total assets seized, an estimated \$1.74 billion worth were available for reconstruction purposes. Another \$927 million in assets located by the United States in Iraq were also used for these purposes. In addition, foreign governments were reported to hold an estimated \$3.7 billion in seized or frozen assets, of which \$847 million had been deposited in the DFI by June 28, 2004. Security Council Resolution 1511 urges member states to deposit seized assets in the DFI immediately.

<sup>9</sup> "Rice Short on Detail in Laying Out Strategy for 'Decisive Iraq Victory', *Financial Times*, October 20, 2005; "Despite Crushing Costs, Iraqi Cabinet Lets Big Subsidies Stand," *New York Times*, August 11, 2005; "Struggling to Pick Up the Pieces," *Economist Newspapers*, September 6, 2005.

<sup>10</sup> Department of State, *Iraq Weekly Status Report*, December 28, 2005. "Iraqis Look to Raise Oil Output Next Year," *Financial Times*, December 29, 2005.

reduction with the Paris Club, Iraq in mid-December began to take steps to end its subsidy of gasoline, increasing the price of fuel from 5 cents to 40 cents a gallon.<sup>11</sup>

## Iraqi Debt

At the time of the invasion, Iraq's debt, both public and private, was estimated at \$125 billion.<sup>12</sup> Since then, the United States has argued that any new Iraqi government should not be burdened with debts associated with the policies of its previous ruler and has supported a near total forgiveness of debt. Some large holders of Iraqi debt — France, Germany, and Russia for instance — were more inclined to reschedule debt than to forgive it, arguing that, as an oil rich country, Iraq could afford someday to pay its debts.<sup>13</sup>

Several steps led to a partial resolution of the debt issue. A series of meetings in early 2004 between the President's personal envoy for Iraq debt reduction, former Secretary of State James Baker III, and the leaders of debt-holding countries led to statements of support, but no firm commitment, for varying levels of relief. By September 2004, Iraq had both assumed sovereignty and cleared its overdue financial obligations to the IMF, making it easier for Iraq to negotiate an agreement with private and government creditors. Further, Congress approved \$360 million (P.L. 108-309) to cover the costs of cancelling the roughly \$4 billion Iraqi debt obligation owed the United States — the U.S. debt was formally forgiven on December 17. These factors culminated in an agreement by the 19 Paris Club government creditors on November 20, 2004, to write off roughly \$31 billion in Iraqi debt, 80% of what it owed to this group. As of October 2005, debt cancellation or reduction agreements had been reached with the United States, Canada, Romania, Malta, and Italy.<sup>14</sup>

## Other Donors

Immediately following the U.S. intervention in Iraq, U.N. appeals for postwar humanitarian relief to Iraq met with \$849 million in grant donations from non-U.S. donors.<sup>15</sup> The Madrid donor conference, held on October 23-24, 2003, produced a

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<sup>11</sup> "At Gas Stations in Iraq, Price Hike Fuels Outrage," *Washington Post*, December 28, 2005; "Despite Crushing Costs, Iraqi Cabinet Lets Big Subsidies Stand," *New York Times*, August 11, 2005; "Iraqi Economy Adds to Tensions with U.S.," *Financial Times*, July 7, 2005; "Iraqis Reluctant to End Love Affair with Fuel Subsidies," *Financial Times*, June 13, 2005.

<sup>12</sup> Based on Paris Club data. Does not include \$29 billion in unpaid Gulf War reparations. International Monetary Fund, *Iraq: Use of Fund Resources — Request for Emergency Post-Conflict Assistance*, September 24, 2004.

<sup>13</sup> G-7 Agrees That Iraq Needs Help with Debt," *Washington Post*, April 13, 2003; "Restructuring, Not Forgiveness," *Financial Times*, April 15, 2003.

<sup>14</sup> SIGIR, *Report to Congress*, October 30, 2005, p. E-9; "Major Creditors Agree to Cancel 80% of Iraq Debt," *New York Times*, November 22, 2004. See CRS Report RS21765, *Iraq: Debt Relief*, by Martin A. Weiss for further details.

<sup>15</sup> As of April 5, 2004. Includes appeal and outside-appeal aid from all donor countries, (continued...)

minimum total of \$13.6 billion in reconstruction aid pledges from other donors — \$3 billion in grant aid and \$9.6 billion in loans. Later pledges have raised the total non-U.S. offer to \$13.9 billion as of September 30, 2005.<sup>16</sup>

At an international conference held in Brussels in June 2005, donors promised to step up their efforts to assist Iraq, although few new financial pledges were made. A July 2005 follow-up conference in Amman, Jordan, did produce an agreement on the use of earlier Japanese and World Bank loan pledges. Iraqi officials at both meetings argued that Iraq is now able to implement development projects on its own and donors need not utilize expensive foreign contractors.<sup>17</sup>

Grant aid pledges from other donors include \$1.5 billion by Japan, \$452 million by the United Kingdom, \$220 million by Spain, \$518 million by the European Union (EU), \$200 million by South Korea, and \$236 million by Italy. Loans have been offered by Japan (\$3.5 billion), the World Bank (between \$3.0 and \$5.0 billion), the IMF (between \$2.6 and \$4.3 billion), and Saudi Arabia (\$500 million). Of these pledges, as much as \$2.7 billion has been disbursed bilaterally, most of it as a contribution to the IRFFI (see below). Additionally, the IMF has provided a \$436 loan and, in November 2005, the World Bank announced its first Iraq loan for a \$100 million education project.<sup>18</sup>

Japan and Britain have been notably active in providing bilateral assistance. Japan, the second largest donor after the United States, has already spent most of the \$1.5 billion in grant aid it pledged. Among other things, it has provided significant funding for electrical power station rehabilitation, water treatment units and tankers, medical equipment, and firetrucks and police vehicles. Britain has offered considerable technical assistance and related support for improvements in the justice system, governance, and economic policy. Iran has been reported to have offered Iraq \$1 billion in low-interest loans (not counted above), expected to target the electricity sector as well as an airport in the holy Shiite city of Najaf.<sup>19</sup>

**Iraq Trust Fund.** During much of the occupation, donors had been reluctant to contribute to reconstruction because they had no say in where the funds are to be allocated.<sup>20</sup> To deal with this concern, a multi-donor trust fund, the International

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<sup>15</sup> (...continued)

except the United States. U.N. Office for the Coordination of Humanitarian Affairs. *Total Humanitarian Assistance for Iraq Crisis 2003*. April 5, 2004, [<http://www.reliefweb.int/rw/dbc.nsf/doc100?openForm>].

<sup>16</sup> SIGIR, *Report to Congress*, October 30, 2005, p. E-2.

<sup>17</sup> "Iraqis Press Donors for Billions More in Reconstruction Aid," *New York Times*, July 19, 2005; "Iraq is Ready for Foreign Aid, Minister Says," *New York Times*, June 20, 2005.

<sup>18</sup> SIGIR, *Report to Congress*, October 30, 2005, Appendix E; "Iraq: World Bank Approves First IDA Credit," World Bank News Release, November 29, 2005.

<sup>19</sup> "Iraq to Build Airport with Help from Iran," *Washington Post*, August 3, 2005; "Iran Extends \$1 Billion Credit to Baghdad," *Financial Times*, July 21, 2005.

<sup>20</sup> "U.S. Seeks Help With Iraq Costs, But Donors Want a Larger Say," *New York Times*, July (continued...)

Reconstruction Fund Facility for Iraq (IRFFI), was established on December 11, 2003. It encourages contributions by keeping them outside the control of the United States, but supports needs identified in the World Bank needs assessment and approved by the Iraqi government. The Facility has two windows, one run by the Bank (the World Bank Iraq Trust Fund) and one by the United Nations (UNDG Iraq Trust Fund). As of August 2005, donors had deposited about \$1.2 billion to the Facility. The World Bank Fund (\$403 million deposited) has financed textbooks, school rehabilitation, and water and sanitation infrastructure, and has provided hundreds of Iraqi civil servants with management training. The UNDG Fund (\$786 million deposited) is supporting a wide range of projects, most to be implemented by the Iraqi government.<sup>21</sup>

**United Nations.** In addition to the above donor projects, the United Nations, since its return to Iraq in early 2004, has been largely responsible for providing assistance and guidance to assist the democratization of Iraq, including support to the transitional government and the Iraqi Electoral Commission. U.N. envoy Lakhdar Brahimi helped negotiate the transition to sovereignty, and a U.N. team headed by Carina Perelli assisted the implementation of elections for the National Assembly, successfully held on January 30, 2005. With U.N. assistance the electoral law was drafted, thousands of registrars were trained, 540 registration centers were set up around the country, millions of ballots were printed, 5,300 voting centers established, and thousands of poll watchers trained. Much of the U.N. work was conducted from outside Iraq, with only about 40 expatriates in Iraq and 600 Iraqi employees implementing activities.<sup>22</sup>

U.N. Security Council Resolution 1637, approved November 8, 2005, extends the U.N. Mission for Iraq (UNAMI) another year and calls on the U.N. to continue to play a leading role in assisting Iraq. The U.N. helped with the constitution-writing process, the subsequent referendum, and the recent parliamentary election. With Trust Fund support, the development organizations within the United Nations are actively working on dozens of projects. Currently, there are about 800 U.N. international and local staff in Iraq.<sup>23</sup>

## U.S. Assistance Policy Structure on Iraq

On June 28, 2004, the Coalition Provisional Authority (CPA), the agency established to temporarily rule Iraq and implement reconstruction programs, was dissolved as Iraq regained its sovereignty. At that time, responsibility for assistance

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<sup>20</sup> (...continued)

14, 2003; "Bush's Plea for Iraq Aid Falls on Deaf Ears," *Financial Times*, September 25, 2003.

<sup>21</sup> Department of State, *2207 Report to Congress*, October 2005, Appendix II.

<sup>22</sup> "U.N. Says Mission Accomplished and That Legitimacy is Now in Hands of Iraqis," *New York Times*, January 26, 2005.

<sup>23</sup> Kofi Annan, "There's Progress in Iraq," *Washington Post*, June 21, 2005; "United Nations to Set Up Trust Fund for Iraq," *Washington File*, November 30, 2004.

programs moved from the Secretary of Defense to the Secretary of State. In Iraq, the United States provides assistance and, to the extent possible, policy guidance to the Iraqi government through its U.S. embassy under Ambassador Zalmay Khalizad. The embassy employs about 1,000 U.S. and 400 Iraqi staff. An Iraq Reconstruction Management Office (IRMO) within the U.S. embassy has supplanted CPA assistance efforts in setting requirements and priorities. It is headed by Ambassador Dan Speckhard.

Responsibility for the activities of the Project and Contracting Office (PCO), formerly the CPA's Program Management Office (PMO), has been taken over by the Army Corps of Engineers, Gulf Region Division, headed by Brig. Gen. William H. McCoy, Jr.<sup>24</sup> The PCO is in charge of contract management and execution for the roughly \$10 billion currently dedicated to infrastructure construction. Although in the Department of Defense, it reports to the Department of State as well as to the Department of the Army.

Immediate overall responsibility for management of U.S. military activity in Iraq belongs to General George Casey, Jr.. As commander of the multinational forces in Iraq, Casey is responsible for establishing a new relationship between coalition forces and the new Iraqi government and providing training and support to Iraqi security forces. He also serves as principal military adviser to the U.S. ambassador. Maj. Gen. Martin E. Dempsey is the officer immediately responsible for overseeing the organization and training of all Iraqi security forces. Although the State Department had assumed control of technical assistance provided to the different Iraq ministries, it has ceded responsibility to DOD for the two ministries most closely involved in security matters — Interior and Defense. Among reasons given for this switch are that DOD has greater resources at its disposal and that State has had difficulty filling advisor positions in these ministries, the latter point disputed by some. In other countries, State has responsibility for training police forces.<sup>25</sup>

The post of CPA Inspector General, created under the FY2004 Emergency Supplemental legislation, was redesignated the Special Inspector General for Iraq Reconstruction (SIGIR) by the DOD Authorization for FY2005 (P.L. 108-375). The SIGIR is currently Stuart Bowen, Jr. The SIGIR reports to both the Secretary of Defense and State. The SIGIR office has about 39 employees examining a range of issues, including the extent and use of competition in contracting; efficient and effective contract management practices; and charges of criminal misconduct. In addition to audits and investigations, the SIGIR issued his first report to Congress on March 30, 2004 and has reported quarterly since then.<sup>26</sup> P.L. 108-375 extended the SIGIR beyond its originally mandated December 2004 expiration and granted operational authority until 10 months after 80% of the reconstruction funds have been obligated. The FY2006 Foreign Operations appropriations (P.L. 109-102) permits

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<sup>24</sup> The PCO and IRMO were established by a National Security Presidential Directive of May 11, 2004. See PCO website at [<http://www.rebuilding-iraq.net>].

<sup>25</sup> "Aid to Iraq Ministries to Shift to Pentagon," *Washington Post*, September 26, 2005.

<sup>26</sup> See [<http://www.cpa-ig.org/>] for reports and audits. SIGIR, *Report to Congress*, October 30, 2005.

it to function until 10 months after 80% of funds have been expended. To date, 53% has been expended.

## **U.S. Reconstruction Assistance**

Among the key policy objectives laid out by the Bush Administration is the economic and political reconstruction of the country. Discussion and debate have been ongoing regarding the strategy to reach these ends utilizing reconstruction aid funds and the effectiveness of aid implementation.

### **Reconstruction Priorities**

Reconstruction priorities have changed over time, mirroring shifting events on the ground. For example, in November 2003 when the CPA decided to accelerate the hand-over of sovereignty, it revised the original legislatively mandated and planned IRRF allocations, increasing substantially the democratization effort — from \$100 million to \$458 million. By the time of the transition in June 2004, about 22% of total FY2004 IRRF funds were targeted on improving the security capabilities of the Iraqi government, including training and equipment for police, army, and customs personnel. About 67% of funds were aimed at improvements in infrastructure — including electricity, oil production, water and sewerage, transportation, and telecommunications — in order to stabilize the country by creating jobs and stimulating the economy. Technical assistance and small-scale grants in such areas as democratization, civil society, microenterprise, education, economic policy, and health accounted for the remainder of FY2004 funds (about 10%).

In September 2004, the Administration proposed and Congress approved (P.L. 108-309) a reallocation of resources, reflecting a review conducted by the Iraq Reconstruction and Management Office and the U.S. Embassy country team after the State Department took charge of Iraq non-military policy on June 28, 2004.<sup>27</sup> The review identified security needs, increased oil production, greater employment, and democracy as the highest priorities, while suggesting that many large-scale infrastructure projects were too slow and dependent on an improved security situation to have an immediate impact. Security — mostly training and equipping Iraqi forces — increased by \$1.8 billion. Efforts to increase oil production capacity gained \$450 million. Employment creation — mostly USAID labor-intensive road, clean water, and other improvement projects — received an additional \$280 million. Democracy programs geared toward assisting the pending elections grew by \$180 million. General development programs — mostly conducted by USAID in the areas of economic reform, private sector development, and agriculture — increased by \$380

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<sup>27</sup> Because the desired changes were greater than the FY2004 supplemental's restriction on how much a specific sector — such as security or health — could be increased (no more than 20%) or decreased (no more than 10%) from the original congressional allocation, a simple notification to the appropriations committees was insufficient. Requiring legislative action in order to accommodate the President's re-allocation plan, Congress included such authority in the FY2005 Continuing Resolution (P.L. 108-309).

million. To demonstrate U.S. commitment to debt reduction prior to a Paris Club discussion of the Iraq issue, the re-allocation drew on \$352.2 million to subsidize U.S. forgiveness of \$4 billion in bilateral Iraqi debt to the United States.

In all, these sectors gained \$3.46 billion of the \$18.44 billion FY2004 supplemental appropriation. That amount was drawn from three sectors to which the funds had originally been allocated — purchases of already refined imported oil (-\$450 million), water and sewerage (-\$1.935 billion), and electricity (-\$1.074 billion) — all sectors where the benefits of planned large-scale projects were viewed as too long-term to make an immediate difference. The re-allocated funds came out of amounts that had not yet been obligated.

**Table 2. Iraq Relief and Reconstruction Fund (IRRF)**  
(\$ millions)

Sector	Current allocation	Obligations as of December 28, 2005	Exp.
<b>FY2004 Supplemental (P.L. 108-106)</b>			
Security and Law Enforcement	5,021*	4,782	4,093
Justice, Public Safety, and Civil Society	1,251*	1,097	670
Democracy	1,004*	968	647
Electricity	4,315	3,042	1,787
Oil Infrastructure	1,723	1,403	657
Water and Sanitation	2,147	1,421	688
Transport and Telecommunications	509	397	209
Roads, Bridges, Construction	334	256	159
Health	786	634	345
Private Sector	840	782	556
Education, Refugees, Human Rights, Governance	363	335	195
Administrative Expenses	213	148	57
<b>Total FY2004 Supplemental</b>	<b>18,505*</b>	<b>15,264</b>	<b>10,062</b>
<b>FY2003 Supplemental (P.L. 108-11)</b>	<b>2,473</b>	<b>2,473</b>	<b>2,407</b>
<b>Total IRRF</b>	<b>20,978</b>	<b>17,737</b>	<b>12,468</b>

\* In its latest reporting, the State Dept. has added \$65.5 million to the IRRF2 total, mostly in the democracy sector. Presumably, these additional sums come from the FY2006 Foreign Operations appropriations.

**Sources:** Department of State, *Iraq Weekly Status Report*, Dec. 28, 2005; *2207 Report*, Oct. 2005.

Following this re-allocation, reconstruction aid priorities in Iraq, as determined by the State Department, put 32% of total FY2004 IRRF funds into security (versus

22% previously), 16% into democratization and traditional development sectors (10% before), and 51% into economic infrastructure (67%).

In December 2004, the Embassy again reviewed its priorities. It allocated \$211 million for fast-disbursing projects to meet needs for electricity and it targeted \$246 million for a variety of high visibility and quick disbursing projects to provide essential services in the four post-battle cities of Fallujah, Samarra, Najaf, and Sadr City. Following another review in March 2005, the State Department reallocated \$832 million of IRRF funds. Of these funds, \$225 million — since changed to \$196 million — is being used for short-term, high visibility, job creation activities, including projects providing essential services in Baghdad (\$100 million), USAID Community Action Program projects (\$100 million), and micro/small business loan programs (\$5 million). The reallocation also includes \$607 million for a number of projects which State expects will make some important reconstruction efforts more sustainable. Among these are operations and maintenance programs in the oil, electricity, and water sectors to insure that training and spare parts are provided to Iraqis so they can manage U.S.-rehabilitated equipment and efforts to complete some work in these sectors where costs have grown due to unanticipated security and newly identified urgent requirements. Most of the reallocated funds again come from canceled long-term energy and water projects.

## Reconstruction Programs and Issues

**Status.** A wide range of reconstruction project work is underway. For a variety of reasons, not least of which is the poor security situation, these efforts have produced a somewhat mixed picture. The Iraqi government appears to be a functioning concern, with ministry staff being trained in budgeting, management, and other work skills. Health facilities continue to be rehabilitated, healthcare providers trained, and children immunized. More than 3,120 grassroots projects have been or are being conducted through USAID grants provided to hundreds of community action groups. School materials have been provided and thousands of schools renovated. Eighty percent of the 800 planned school construction projects have been completed. A broad range of economic policy reform efforts has been initiated. Business centers have been set up throughout the country and a micro-loan program established. Voter education, training of election monitors, and related activities contributed to three successful elections in 2005. Construction utilizing FY2004 funds has greatly accelerated in the past year; in all about 2,427 construction projects have broken ground and 1,607 of these have been completed. More broadly, the Iraqi economy continues to improve and the IMF predicts 10% growth for 2006.<sup>28</sup>

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<sup>28</sup> Another 465 projects using \$313 million of Iraqi AIRP funds (the Accelerated Iraqi Reconstruction Program) have been started, of which 398 have been completed. PCO, *Iraq Reconstruction Weekly Update*; Department of State, *Iraq Weekly Status Report*, Dec. 28, 2005; USAID, *Iraq Reconstruction Weekly Update*, Dec. 23, 2005; "Iraqis Look to Raise Oil Output Next Year," *Financial Times*, December 29, 2005; "Billions Pour into Iraq Reconstruction Efforts," *Financial Times*, December 8, 2005; "U.S. Official Defends Pace of Iraqi Reconstruction," *New York Times*, November 14, 2005.



Positive claims for the success of reconstruction programs during the past two and a half years have been countered by reports of slow and ineffective implementation. Although project completion rates now appear to be greatly improved, for more than a year projects were slow to get off the ground. Objectives in critical sectors, such as oil production and electric power generation, have not been met. Electric power was 95,600 Megawatt Hours before the war. It is currently below 100,000 MWh — the goal has been 120,000. Oil production is currently at 2.0 million barrels/day — the goal was 2.8-3.0 million by December 2004. A survey reportedly has found that 85% of households lack stable electricity and 54% lack access to clean water. The one consistent bright spot among reconstruction claims — a successful health program — was marred by reports in late 2004 that acute malnutrition among children had nearly doubled since the coalition invasion in 2003.<sup>29</sup> Anecdotal reports of successful reconstruction programs, not surprisingly, emanate from the Kurdish north and the Shiite south. In the four central provinces where there is significant turmoil and more than 40% of the population resides, reports are less sanguine.<sup>30</sup>

**Rate of Implementation.** A particular congressional concern has been the rate of project implementation. Although the Administration had argued an urgent need to demonstrate progress, employ Iraqis, and win hearts and minds, only about 12% of the \$18.4 billion FY2004 supplemental had been obligated six months after it was appropriated in November 2003.<sup>31</sup> Among reasons for the slow progress were pressures to employ open and competitive bidding for the new reconstruction contracts, inter-agency disputes over control of the funds, and time required for planning and design of construction projects prior to breaking ground. A significant delaying factor has been the lack of security. The September 2004 re-allocation of U.S. reconstruction funds was, in part, intended to speed up implementation,

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<sup>29</sup> Department of State, *Iraq Weekly Status Report*, December 28, 2005; “U.S. Lowers Sights on What Can Be Achieved in Iraq,” *Washington Post*, August 14, 2005; “Head of Reconstruction Says Unexpected Security Costs Eating Into Budget,” *Washington Post*, May 22, 2005; “Iraqis Wait for Better Days That Never Come,” *Financial Times*, May 3, 2005; “Power Grid in Iraq Far From Fixed,” *Washington Post*, May 1, 2005; “A Promise Unfulfilled: Iraq’s Oil Output is Lagging,” *New York Times*, May 2, 2005; “Children Pay Cost of Iraq’s Chaos,” *Washington Post*, November 21, 2004; “U.S. Handing Over An Unfulfilled Iraq,” *Chicago Tribune*, June 27, 2004; “Reality Intrudes on Promises in Rebuilding of Iraq,” *New York Times*, June 30, 2004.

<sup>30</sup> “Iraq’s Kurds Enjoy Self-Rule and Are Trying to Keep It,” *New York Times*, December 31, 2004; “Basra Revival, But It’s Harder Than Expected,” *New York Times*, January 19, 2005; “Even in Iraqi City Cited as Model, Rebuilding Efforts are Hobbled,” *New York Times*, September 18, 2005; “Baghdad Neighborhood’s Hopes Dimmed by the Trials of War,” *Washington Post*, September 27, 2005; “Funds Fade, Deaths Rise, and Iraq Rebuilding is Spotty,” *New York Times*, October 31, 2005; “President’s Account of Gains Depicts Only Part of the Picture,” *New York Times*, December 8, 2005.

<sup>31</sup> To compensate for the slow rate of implementation, in April 2004, CPA-head Bremer initiated the Accelerated Iraqi Reconstruction Program (AIRP) which utilized Iraqi DFI funds (\$313 million) to get work underway in ten cities.

including the expanded use of smaller projects.<sup>32</sup> That effort was pushed further by a December 2004 targeting of \$457 million specifically to rapid-disbursing grassroots projects and a March 2005 reallocation favoring short-term priorities. Partly as a result, since mid-2004, the obligation and expenditure rate has accelerated notably, and, currently, of the total \$21 billion in IRRF funding, 85% has been obligated and 59% has been spent.<sup>33</sup> Nevertheless, the availability of as much as \$5 billion in unobligated funds in mid-2005 led Congress to reject most of the Administration's FY2006 Iraq aid request. As of end-December, \$3.2 billion remains unobligated.

**Security.** The successful conduct of much reconstruction work is contingent on an environment of order and stability. Approaching three years since Operation Iraqi Freedom was launched, violence persists against both U.S. forces and Iraqis. Among the many effects of the continued instability on the reconstruction effort:

- The instability has delayed implementation of reconstruction projects.
- Completed reconstruction projects and pre-existing infrastructure have been destroyed. Major pipelines have been sabotaged, shutting down oil exports, with the consequent loss of hundreds of millions of dollars in revenue. In 2004, power was cut to more than 100 electrical lines, and nearly 1,200 electrical towers were felled. In the Sunni triangle, small-scale rehabilitation projects have been destroyed soon after completion.<sup>34</sup>
- Reconstruction costs have risen due to the need to provide for security and insurance for personnel. Estimates of the portion of project costs devoted to security vary widely, from 16%-22% (State Department, May 2005), 22% (USAID, September 2005), 5-8.5% (USAID, noted in October 2005 SIGIR report), 6-80% (State Dept, October 2005). In any case, project security costs as well as the related need to shift \$1.8 billion from water and power projects to the training and equipping of Iraqi forces has meant that funds have been drained from infrastructure programs. Among other results, USAID cancelled two electric power generation programs; the Army Corps of Engineers cut a planned 23 electric substation rehabilitation program to nine.<sup>35</sup>

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<sup>32</sup> "U.S. Seeks to Provide More Jobs and Speed Rebuilding in Iraq," *New York Times*, July 27, 2004.

<sup>33</sup> Department of State, *Iraq Weekly Status Report*, December 28, 2005.

<sup>34</sup> Charles Hess, DOD News Briefing, December 15, 2004; "Insurgents Wage Precise Attacks on Baghdad Fuel," *New York Times*, February 21, 2005; "Sabotage Cuts Power to More Than 100 Electrical Lines," *New York Times*, June 11, 2004.

<sup>35</sup> Howard Krongard, State Department IG, testimony to House Government Reform Committee, October 18, 2005; State Department, 2207 Report to Congress, July 2005; SIGIR, *Report to Congress*, July 30, 2005 and October 30, 2005; James Kunder, USAID, (continued...)

- Iraqi government-budgeted funds planned for the operation and maintenance of U.S.-funded infrastructure projects have had to be diverted to pay for security forces. To insure that U.S. projects are sustainable, U.S. funds have been taken from other programs.<sup>36</sup>
- Projects to which funds have been committed may cost more to complete than originally anticipated. According to the SIGIR, USAID projects funded with the FY2003 supplemental have been about 20% more expensive than the original estimates, and a sampling of FY2004-funded USAID and PCO projects suggests these may be as much as 50%-85% more costly to complete than the initial cost estimates. This trend, likely due in large part to unexpected security expenses, may severely decrease the number of reconstruction projects the United States is able to undertake in Iraq unless additional funding is provided.<sup>37</sup>
- Implementing organizations and personnel have fled. Fearing for their safety, many aid implementors have been withdrawn from the country. U.N. and bilateral aid donors have been reluctant to initiate projects of their own; many, including the U.N., are running programs from Jordan or Kuwait utilizing Iraqi personnel to the extent possible.<sup>38</sup>
- The quality of aid has likely been negatively affected as implementors cannot meet with local people and design and monitor projects as they would in other countries. The pool of foreign expertise available to advise the government and NGOs is restricted to those few willing to endure the country's hardships. U.S. agency personnel stay only a short time and therefore institutional knowledge is not maintained. Iraqi experts necessary to successful

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<sup>35</sup> (...continued)

testimony to House Foreign Operations Subcommittee, September 7, 2005; "Security Costs Slow Iraq Reconstruction," *Washington Post*, July 29, 2005; "Thanks to Guards, Iraq Oil Pipeline is Up and Running, On and Off," *New York Times*, September 3, 2005.

<sup>36</sup> Ambassador Jeffrey, Testimony to House Foreign Operations Appropriations Subcommittee, September 7, 2005.

<sup>37</sup> SIGIR, *Report to Congress*, April 30, 2005, pp. 75-78. The July 30, 2005, SIGIR Report notes that efforts are currently being made to gather program management data that may elucidate the amount of funds available and/or necessary to complete current and new projects.

<sup>38</sup> "Wolfowitz Says Iraq Violence Impedes Rebuilding Aid," *Wall Street Journal*, June 1, 2005; "Driven from Iraq, Aid Groups Reflect on Work Half Begun," *New York Times*, November 15, 2004; "Security Conditions Continue to Hamper U.N. in Iraq," *Washington File*, August 11, 2004; "Charities Get Ready to Leave," *London Times*, September 9, 2004.

reconstruction have left — ten percent of registered doctors have reportedly given up work in the past year.<sup>39</sup>

- In a broader sense, prolonged insecurity has undermined the trust of the Iraqi people in U.S. and now Iraqi government leadership to bring about a democratic and economic transformation in Iraq, opening the door to further political discontent and possible civil war.<sup>40</sup>

There are two elements in the effort to provide the security that might allow political and economic reconstruction to take hold — U.S. and coalition peacekeeping forces and the training of Iraqi security forces to replace them. The number of U.S. troops is expected to return to roughly 138,000 early in 2006 from 160,000 in November, and drop by 5-7,000 by Spring. There are also about 23,000 troops from 28 other nations.<sup>41</sup> As violence and hostage-taking increased through 2004 and into 2005, many participating countries, including the Philippines, Hungary, the Netherlands, Ukraine, Poland, and Italy announced reductions or departures. Although NATO rejected the Administration request that it provide forces, it did agree to help train Iraqi troops, and all NATO members currently provide training or equipment. Six NATO members refuse to send troops to conduct training inside Iraq, but France and Germany have committed to training forces elsewhere.<sup>42</sup>

Thirty-eight percent of total U.S. appropriations for reconstruction — nearly \$11 billion — are aimed at building Iraqi security forces. Most of these funds — \$7.5 billion — have been added since September 2004, as the security situation remained unstable and efforts to train forces appeared inadequate. According to the State Department, at end-December there were 75,700 trained and equipped conventional Iraqi police. In addition, there were 101,600 army forces. Efforts are also being made now to train and equip Strategic Infrastructure Battalions to protect oil and electrical facilities. Officials believe 325,000 security forces are needed to defeat the insurgency. In all, about 223,700 security forces are currently defined by officials as ready for action. However, reports by officials and observers have suggested that

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<sup>39</sup> “Facing Chaos, Iraqi Doctors are Quitting,” *New York Times*, May 30, 2005; SIGIR, *Report to Congress*, July 30, 2005, p. 20; “World Bank Considers Sending Staff Back to Baghdad,” *Washington Post*, September 18, 2005.

<sup>40</sup> “In Jaded, Perilous Capital, A Collision of Perceptions,” *Washington Post*, July 29, 2005; “As Violence Deepens, So Does Pessimism,” *Washington Post*, May 18, 2004; “Fueling Anger in Iraq,” *Washington Post*, December 9, 2003; “The Best, Brightest, and Wealthiest Flee Iraq,” *Chicago Tribune*, November 21, 2004.

<sup>41</sup> *Iraq Index*, Brookings Institution, [<http://www.brookings.edu/iraqindex>], December 22, 2005, page 19; Department of State, *Iraq Weekly Status Report*, December 28, 2005.

<sup>42</sup> “NATO Reports All 26 Nations are Aiding Iraq with Training,” *New York Times*, September 22, 2005; “NATO Agrees on Modest Plan for Training Iraqi Forces,” *New York Times*, February 23, 2005; “Coalition Members Look for an Exit,” *Washington Post*, November 23, 2005.

many fewer could be said to be capable of the most demanding jobs.<sup>43</sup> During the past three years, poorly trained and equipped security forces, no-shows and desertions, dismissals of police for criminal behavior, and bribe-taking for obtaining higher rank or for release of insurgent suspects have threatened U.S. plans to increase security using Iraqi personnel.<sup>44</sup> Increasing attention is now being paid by U.S. officials to the lack of adequate logistical capabilities in the Iraqi Ministry of Defense. Problems in paying, feeding, and supplying equipment to troops are compounded by reports of corruption in the Ministry procurement office.<sup>45</sup>

**Implementing Agencies.** Dozens of U.S. and international companies and NGOs are participating in the reconstruction of Iraq.<sup>46</sup> The bulk of FY2004 IRRF programs — the roughly \$11.3 billion dedicated to construction — is managed by the Project and Contracting Office (PCO). The PCO coordinates, manages and monitors contracting and expenditures in six sectors — transport and communications; electricity; buildings/health; security/justice; public works/water resources; and oil. The PCO's parent organization, the Department of Defense, is responsible for security training. Together, they account for roughly 73% of the \$17.9 billion in FY2004 IRRF appropriations that had been allocated as of September 2005.

Responsible for 17% of allocated FY2004 appropriations (\$3.0 billion), the Agency for International Development (USAID), manages the widest range of economic, social, and political development programs. Its programs include a \$1.8 billion construction project contracted to Bechtel and most activities related to public health, agricultural development, basic and higher education, civil society, local governance, democratization, and policy reform.<sup>47</sup> Other U.S. government agencies

<sup>43</sup> State Department, *2207 Report to Congress*, October 2005, p. 6; "Iraqis Not Ready to Fight Rebels on Own, U.S. Says," *New York Times*, July 21, 2005; "Building Iraq's Army: Mission Improbable," *Washington Post*, June 10, 2005; "As Iraqi Army Trains, Word in Field is It May Take Years," *New York Times*, June 13, 2005; "Pentagon Says Iraqi Forces Are Improving, but Still Can't Fight Alone," *New York Times*, October 14, 2005; Department of State, *Iraq Weekly StatusReport*, December 28, 2005.

<sup>44</sup> "Iraqi Security Has Come Far, With Far to Go," *Washington Post*, August 1, 2004; "Wanted: Police Academy ASAP," *Washington Post*, May 16, 2004; "Iraqi Battalion Refuses to 'Fight Iraqis'," *Washington Post*, April 11, 2004; "Iraqi Police Suspected in Slaying of Americans," *Washington Post*, March 13, 2004; "Recruits Abandon Iraqi Army," *Washington Post*, December 13, 2003; "U.S. Needs More Time to Train and Equip Iraqis," *New York Times*, May 24, 2004; "Iraqis Readiness Disputed in Hearing," *Washington Post*, January 20, 2005. "U.S. Says Police in Iraq Need Bolstering," *Washington Post*, November 25, 2004. "U.S. Officials Say Iraq's Forces Founder Under Rebel Assaults," *New York Times*, November 30, 2004.

<sup>45</sup> "Worry Grows as Iraq's Defense Ministry Falls Short of Expectations," *New York Times*, August 3, 2005.

<sup>46</sup> For information on contract awards and solicitations, and business opportunities in Iraq, see the following websites: the Iraq Project and Contracting Office [<http://www.rebuilding-iraq.net>], USAID's Iraq Reconstruction effort [<http://www.usaid.gov/iraq/activities.html>]; and the Department of Commerce (DOC) Iraq Reconstruction Task Force [<http://www.export.gov/iraq/>].

<sup>47</sup> Most FY2003 IRRF funds (73%) were utilized by USAID. It awarded \$1.8 billion in (continued...)

involved in the reconstruction effort include the Department of State (accounting for 7% of FY2004 allocations), which continues work begun in 2003 providing police training, and the Treasury Department (0.2%), which provides economic advice to the transition government.<sup>48</sup>

**CERP and CHRRP.** Until recently, drawn from DFI Iraqi seized assets and oil profits and Department of Defense funds rather than reconstruction appropriations, the Commander's Emergency Response Program (CERP) contributes to the reconstruction effort by providing "walking around money" for U.S. military civil affairs officers throughout Iraq. Up to end-September, a total of \$1.4 billion — \$548 million in Iraqi funds and \$858 million in U.S. DOD appropriations — has been made available for this purpose. Up to an additional \$500 million may be drawn upon using FY2006 DOD appropriations. The CERP supports a wide variety of reconstruction activities at the village level from renovating health clinics to digging wells to painting schools, provided in the form of small grants. In lieu of civilian U.S. government or NGO aid personnel, who are not present in most of the country, commanders identify local needs and dispense aid with few bureaucratic encumbrances. The grants have been credited with helping the military better exercise their security missions, while at the same time meeting immediate neighborhood development needs. The Commanders Humanitarian Relief and Reconstruction Program (CHRRP) uses IRRF funds — \$84 million to date — combined with Iraqi government grants — \$136 million — for similar purposes. CHRRP projects are usually conducted on a larger-scale.<sup>49</sup>

**The Role of Iraqis in Reconstruction.** One facet of the U.S. reconstruction effort has been to attempt to encourage economic growth and decrease unemployment by trying to utilize Iraqis to the extent possible in the implementation of projects. In the first year, this involved making Iraqi businessmen aware of contract opportunities and encouraging U.S. contractors to employ Iraqi firms. Although U.S. government requirements could be waived for Iraqi contractors, most work for Iraqi business came in the form of subcontracts for U.S. prime contractors.

Since the State Department took over reconstruction in July 2004, however, greater efforts have been made to contract project work directly with Iraqis. According to the SIGIR, in the first quarter of FY2005, 40% of new contracts were awarded to Iraqi companies. SIGIR estimates that about 70%-80% of contracting is now directly with Iraqis.<sup>50</sup> One new factor in this effort has been the deleterious impact of security on the activities of the large-scale contractors. In January 2005, Contrack International, holder of a \$325 million roads and bridges construction

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<sup>47</sup> (...continued)

contracts and grants in the abovementioned sectors, as well as in seaport and airport administration, capital construction, theater logistical support, and personnel support. All FY2005 funding — \$5.7 billion for Iraqi security force training — is managed by DOD.

<sup>48</sup> SIGIR, *Report to Congress*, October 30, 2005, Appendix C.

<sup>49</sup> SIGIR, *Report to Congress*, October 30, 2005, Appendix B.

<sup>50</sup> SIGIR, *Report to Congress*, January 30, 2005, p. 106. Stuart Bowen, Testimony to House Foreign Operations Appropriations Subcommittee, September 7, 2005.

contract, announced its withdrawal.<sup>51</sup> Consequently, many bridge and road projects are being implemented directly with the Ministry of Construction, with estimated savings of between 30% and 40%.<sup>52</sup> USAID has also used Iraqi Ministry employees to implement electrical distribution projects in Baghdad. Efforts have been made as well to give the Iraqi Government some decision-making responsibility over U.S.-funded reconstruction work, including on-site supervision and drafting of contracts. It is also working to develop the capacity of private sector contractors, especially women-owned businesses, to respond to Iraqi government contracting opportunities in the future. The PCO claims that hundreds of Iraqi firms are currently working on U.S.-funded reconstruction projects. About 103,000 Iraqis are employed under all U.S.-funded projects.<sup>53</sup>

As it has sought to involve Iraqis in the reconstruction process, the embassy has expanded its outreach to the provinces. It has encouraged the creation of Iraqi Provincial Reconstruction Development Committees (PRDCs) in provinces throughout the country. The PRDCs are composed of local and national government representatives. At the same time, the embassy is establishing Provincial Support Teams (PSTs), made up of embassy, PCO, and USAID staff (only three had been established as of December). The intention is that these two entities work together to identify projects which can be implemented and carried out with U.S. financing. As a result, it is hoped local governments may be strengthened while U.S. projects achieve more lasting support. An additional benefit of the PSTs is that U.S. agencies may better coordinate their reconstruction programs. In its June 2005 review of resources, the IRMO allocated \$241 million of IRRF funds to back the PRDC-PST partnership — \$80 million used through the CERP and \$161 million through USAID's Community Action Program (CAP) and Local Governance Program (LGP).<sup>54</sup>

**Project Sustainability.** As more large-scale construction projects are completed, there is increasing concern regarding the ability of Iraqis to maintain them physically and fund them financially once they are handed-over to Iraqi authorities. A "principal objective" of PCO contracting has always been the "swift transition of the reconstruction effort to Iraqi management and control."<sup>55</sup> To insure long-term sustainability, the PCO is focusing on what they call capacity development. At this point, each contractor is responsible for providing training to the appropriate personnel in the labor force who will operate and maintain power plants, water systems, etc., and contractors are liable for repairs and equipment replacement for a period of 90 days following project completion. At the Ministry level, the PCO is assisting development of policies and laws conducive to efficient use and

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<sup>51</sup> BNA, Inc. Federal Contracts Report, January 11, 2005

<sup>52</sup> Ambassador Jeffrey, Testimony to House Foreign Operations Subcommittee, September 7, 2005. State Department, *2207 Report to Congress*, October 2005, p. 3.

<sup>53</sup> Department of State, *Iraq Weekly Status Report*, December 28, 2005; State Department, *2207 Report to Congress*, July 2005, p. 2.

<sup>54</sup> Department of State, *2207 Report to Congress*, July 2005, p. 2.

<sup>55</sup> Iraq Reconstruction Pre-Proposal Conference Briefing Slide Show, DOD, Jan. 21, 2004.

maintenance of infrastructure. The SIGIR has pressed the embassy to encourage ministries to develop strategic plans for sustainment of its infrastructure.<sup>56</sup>

According to the SIGIR, the State Department has identified \$425 million in IRRF funds that have been already been spent or are programmed to be used to help sustain projects. Of this \$31.5 million has been for capacity development programs at the Iraqi ministry level. In addition, State is considering diverting funds from planned IRRF projects to bolster sustainment. But the long-term responsibility for sustainability lies with the Iraqi government, and the SIGIR estimates that between \$650 and \$750 million annually would be needed to operate and maintain U.S.-sponsored projects alone. When security, salaries, and fuel are included the estimate increases to between \$750 and \$950 million annually.<sup>57</sup> Whether the Iraqi government can shoulder the burden of additional costs — it is already running a deficit — will depend on the level of resources it is able to draw on from oil profits and international donors.

**How Much Assistance Reaches Iraq?** How much of the nearly \$21 billion in reconstruction assistance reaches Iraq has been an issue of some concern. As noted earlier, one consequence of the unstable and dangerous environment in which reconstruction programs are implemented has been the high cost of providing security to employees. Estimates for security range anywhere from 5% to as much as 80% of project expenses, but actual costs would vary project by project, depending on location, type of activity, and numbers of foreign employees. An additional program cost related to security is insurance for employees, salaries, and housing — all of which are likely higher than in other locations in the world. Corruption and mismanagement, which are thought to be prevalent in Iraq, would also drain project funds. In December 2004, the Post-Conflict Reconstruction Project at the Center for Strategic and International Studies estimated security costs at 30% of project funds; insurance and salaries at 12%; corruption at 15%; overhead at 10%; and profits at 6%. If these estimates are accurate, actual reconstruction services and infrastructure investments may only account for about 27% of total aid. However, it should be noted that such estimates might vary widely according to the type of aid provided. The CSIS estimate is more likely to apply to large-scale infrastructure construction projects than to projects where the assistance is delivered in the form of a few experts or grassroots community development grants.<sup>58</sup>

**The Reconstruction Gap.** Many of the projects that were originally promised to the Iraqis and for which funds were appropriated by Congress cannot be completed with the sums allotted. The SIGIR attributes this “reconstruction gap” to a number of factors, including the unexpected higher cost of security to protect projects and project personnel; the higher cost for materials, especially in the oil

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<sup>56</sup> Briefing by PCO on Capacity Development, March 17, 2005; State Department, 2207 *Report to Congress*, June 2005, p. 5.

<sup>57</sup> SIGIR, *Managing Sustainment for Iraq Relief and Reconstruction Fund Programs*, Report Number 05-022, October 24, 2005.

<sup>58</sup> CSIS, Post-Conflict Reconstruction Project, *Estimated Breakdown of Funding Flows for Iraq's Reconstruction: How are the Funds Being Spent?*, December 2004.



sector; higher costs due to project delays, many deriving from security disruptions; the reprogramming of planned assistance in sectors such as electricity and water to other sectors such as security and oil production; and the increased need to provide for long-term sustainability of projects. The SIGIR is now conducting a study to determine the size of the reconstruction gap.<sup>59</sup> Its findings may point to an increased burden that the Iraqi government will have to face on its own, windows of opportunity for other donors, or a possible program for future U.S. assistance.

## **Accountability, Waste, and Fraud**

A lack of transparency in early contracting and numerous reports in the media suggesting that reconstruction funds were being squandered led to the establishment in the FY2004 supplemental of an Inspector General for the CPA, now called the Special Inspector General for Iraq Reconstruction (SIGIR).<sup>60</sup> The SIGIR has issued a number of audits and launched dozens of investigations of possible criminal activity.<sup>61</sup> Up to now, however, the most egregious examples of waste and fraud appear to center, not on IRRF reconstruction aid, but on DOD appropriations — especially the Halliburton Kellogg, Brown & Root projects — and on the CPA's use of Iraqi funds (see the DFI section below).<sup>62</sup>

During the past eight months SIGIR project assessment teams with engineering, audit, and investigative experience have traveled to major reconstruction project sites to see if work is being performed properly. Among the more worrying findings to date has come from a look at four water projects in central Iraq — three of the four

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<sup>59</sup> SIGIR, *Report to Congress*, October 30, 2005, p. 3.

<sup>60</sup> For example, a cement plant's renovation, estimated to cost \$15 million by U.S. engineers, was repaired by Iraqis for \$80,000. [Rep. Henry Waxman, letter to Joshua Bolten, Director of OMB, Sept. 26, 2003.] The Governing Council questioned a decision by the CPA to spend \$1.2 billion training 35,000 police in Jordan rather than in Iraq at, in its view, "a fraction of the cost." ("Iraqis Say U.S. Occupation Authority Misspend Millions in Its Awarding of Contracts," *New York Times*, Oct. 4, 2003.) Press reports suggested that ministry equipment was sold on the streets and reconstruction subcontracts were delivered for bribes. ("Spoils of War," National Public Radio, April 21-23, 2004.) The Department of Defense IG found numerous "irregularities" in contracting procedures followed by DOD acquisition support for the CPA and its predecessor through August 2003. (DOD IG Audit, *Contracts Awarded for the Coalition Provisional Authority by the Defense Contracting Command*, Report No. D-2004-057, March 18, 2004.) The State Department IG found contractor DynCorp had overcharged \$685,000 for services rendered to the Bureau of International Narcotics and Law Enforcement Affairs police training program. (SIGIR report, Jan. 30, 2005, p. 21.)

<sup>61</sup> See SIGIR website [<http://www.cpa-ig.org/>] for audit reports to date. SIGIR, *Report to Congress*, October 30, 2005, Appendix G.

<sup>62</sup> At an October 18, 2005 congressional hearing (House Government Reform Committee), the DOD IG revealed that all DOD IG office personnel had been withdrawn from Iraq in the previous year; the Army Audit Agency, however, does have auditors in Iraq and is following the KBR LOGCAP contract. For a summary of the Halliburton issues, see Joint Report of the House Committee on Government Reform Minority Staff and Senate Democratic Policy Committee, *Halliburton's Questioned and Unsupported Costs in Iraq Exceed \$1.4 Billion*, June 27, 2005.

reviews found problems, including inadequate design work, insufficient quality control, and the failure of Government project engineers to approve invoices and recommend payment.<sup>63</sup> An assessment of five electrical substations was positive for the substations themselves, but found that installation of distribution lines to the end users, part of the original plan, had to be eliminated (presumably due to funding reallocations) and, therefore, the benefits of the new substations will not be derived until the Ministry of Electricity can perform the work. On the other hand, assessments of other projects were either largely positive or helped point out correctable quality control and structural deficiencies, suggesting that the IG investigations are playing a role in motivating contractors to perform work as required.<sup>64</sup>

**The Development Fund for Iraq (DFI).** Many questions have been raised regarding the CPA's use and monitoring of DFI funds. Although the funds were derived from Iraqi, mostly oil, resources, under Security Council Resolution 1483 (May 2003) the CPA had complete control over them during the occupation. To prioritize and recommend how DFI resources were used, the CPA established a Program Review Board in June 2003. Although composed of coalition, multilateral bank, and U.N. officials, the multilateral bank members had no vote and the U.N. official served only as an observer. The Program Review Board published brief minutes of its meetings but little detail regarding the nearly 2,000 contracts it awarded utilizing Iraqi funds. Reportedly, U.S. contractors received as much as \$1.9 billion of DFI funds, of which Halliburton subsidiary Kellogg, Brown & Root (KBR) was awarded \$1.7 billion.<sup>65</sup>

Security Council Resolution 1483 required that an international advisory board to monitor the sale and use of oil be established, but at first the CPA opposed international institution efforts to create a system of "special audits" that would allow the board to look at any issue. CPA failure to establish the board led to international criticism, and Security Council Resolution 1511 (October 2003) recommended that the board be established as a priority and that the DFI should be "used in a transparent manner."<sup>66</sup> Soon after, the CPA announced that it would allow the advisory board to go forward and the first meeting of the International Advisory and Monitoring Board (IAMB) was held on December 5, 2003. However, a delay in appointing accountants by the CPA continued to prevent work up to early February 2004. In March 2004, the IAMB recommended installation of a metering system for oil extraction to prevent diversion, and criticized the use of non-competitive bidding for contracts funded by the DFI.<sup>67</sup>

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<sup>63</sup> SIGIR, *Report to Congress*, July 30, 2005, p. 60-66.

<sup>64</sup> SIGIR, *Report to Congress*, October 30, 2005, p. 47-58.

<sup>65</sup> "\$1.9 Billion of Iraq's Money Goes to U.S. Contractors," *Washington Post*, August 4, 2004.

<sup>66</sup> Security Council Resolution 1511, October 16, 2003, para. 23. "Oil to Come Under Iraqi Control as U.S. Fails to Form Advisory Board," *Financial Times*, August 19, 2003; "Annan Deals a Blow to U.S. Draft Resolution," *Financial Times*, October 3, 2003.

<sup>67</sup> The IAMB website is at [<http://www.iamb.info/>]; IAMB, Press Release, March 24, 2004; (continued...)

In its June 2004 audit, KPMG, the accounting firm designated by the IAMB to audit the DFI, noted the CPA's inadequate accounting systems and records and lack of controls over ministry spending of DFI resources, opening the door for corruption. KPMG also pointed out the use of non-competitive bidding for some contracts funded by the DFI. Subsequent audits highlighted multiple financial irregularities.<sup>68</sup> A representative on the IAMB accused the Administration of withholding information on non-competitive contracts, and repeated requests to U.S. agencies for information on sole-sourced contracts funded by the DFI were not answered.<sup>69</sup> The organization Christian Aid accused the CPA of being "in flagrant breach of the U.N. resolution" giving it use of DFI funds. "Last minute" spending by the CPA of \$2.5 billion in DFI resources in the weeks prior to the turn-over of sovereignty also drew critical attention. Among other things, the spending went for equipment for security forces, vocational training, and oil and electric infrastructure, and local projects. Iraqi officials, too, were critical of the contrast between the slow spending of U.S. funds and the rapid draw-down of the DFI.<sup>70</sup>

A January 2005 audit by the SIGIR seems to have confirmed the IAMB accusations with a finding that the CPA "provided less than adequate controls" for \$8.8 billion of DFI resources it moved through Iraqi ministries.<sup>71</sup> An April 2005 SIGIR audit concluded that CPA managers of DFI funds distributed in the South-Central region of Iraq could not account for more than \$96.6 million in cash and receipts. An October 2005 audit found that South-Central personnel could not account for more than \$20.5 million in Rapid Regional Response Program funds and made \$2.6 million in excessive payments. In late 2005, several U.S. citizens were criminally charged with respect to the handling of these funds.<sup>72</sup>

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<sup>67</sup> (...continued)

"Monitoring Panel for Iraq Spending Yet to Start Work," *Financial Times*, February 5, 2004.

<sup>68</sup> KPMG Audit dated June 29, 2004, available online at IAMB website [<http://www.iamb.info/>]; Iraq Revenue Watch, *Disorder, Negligence and Mismanagement: How the CPA Handled Iraq Reconstruction Funds*, Report no. 7, September 2004; Iraq Revenue Watch, *Audit Finds More Irregularities and Mismanagement of Iraq's Resources*, December 2004; "Big Spender," *Financial Times*, December 10, 2004.

<sup>69</sup> Press Release, "Statement by the International Advisory and Monitoring Board on Iraq," September 8, 2004; "U.S. Won't Turn Over Data for Iraq Audits," *Washington Post*, July 16, 2004.

<sup>70</sup> Christian Aid, *Fuelling Suspicion: the Coalition and Iraq's Oil Billions*, June 2004; "U.S. Is Quietly Spending \$2.5 Billion from Iraqi Oil Revenue to Pay for Iraqi Projects," *New York Times*, June 21, 2004.

<sup>71</sup> According to IG Bowen, the Iraq Commission on Public Integrity is investigating \$1.5 billion that may have gone missing in the Ministry of Defense. "Special Inspector General Stuart Bowen," *Washington Post*, November 9, 2005.

<sup>72</sup> Among other things, the SIGIR found a \$500,000 contract in Karbala that was not carried out, a \$1 million grant for training librarians that was not delivered, and a half constructed \$7.3 million police academy. "Special Inspector General Stuart Bowen," *Washington Post*, November 9, 2005; "U.S. Accuses Pair of Rigging Iraq Contracts," *Washington Post*, November 18, 2005; "2<sup>nd</sup> Army Officer Charged in Iraq Rebuilding Scandal," *New York Times* (continued...)

In addition, an October 2004 Pentagon audit of a KBR noncompetitive contract to import oil into Iraq found \$100 million in excess charges of \$875 million examined. Of the \$875 million, \$725 million are DFI funds, and \$72 million in U.S. appropriations. Although the Pentagon agreed to an IAMB request that it conduct by spring 2005 a special audit of all 24 noncompetitive contracts funded out of the DFI, it reportedly moved slowly to meet that request and it was not submitted until September.<sup>73</sup> In December, the IAMB called on the United States to “seek resolution” with the Iraqi government — possibly make repayment — on up to \$208 million of Iraqi funds that went to KBR for work that had been questioned by the Defense Contract Audit Agency.<sup>74</sup>

## Assessments of Reconstruction

There have been dozens of reports and articles during the past two years that have sought to analyze, criticize, and recommend action regarding the progress of reconstruction aid.<sup>75</sup> Most focus on the history of the occupation and those problems that help explain the current state of affairs. For example, *Reconstructing Iraq*, a September 2004 report from the International Crisis Group, examines the gamut of mistakes that many agree were made prior to and during the occupation. These include the lack of a reconstruction plan; the failure to adequately fund reconstruction early on; unrealistic application of U.S. views to Iraqi conditions by, for example, emphasizing privatization policy; the organizational incompetence of the CPA; shifting deadlines, such as the November 2003 decision to end the occupation seven months later; and the inadequate utilization of Iraqis both in making policy and in

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<sup>72</sup> (...continued)

*Times*, December 16, 2005; *Management of Rapid Regional Response Program Grants in South-Central Iraq*, Report No. 05-015, October 25, 2005; *Audit of Oversight of Funds Provided to Iraqi Ministries through the National Budget Process*, Report No. 05-004, January 30, 2005; and *Control of Cash Provided to South-Central Iraq*, Audit Report No. 05-006, April 30, 2005, available at SIGIR website [<http://www.cpa-ig.org>].

<sup>73</sup> “Now You See It: An Audit of KBR,” *New York Times*, March 20, 2005; Defense Contract Audit Agency, Audit Report 3311, October 8, 2004, available at Government Reform Committee minority website [<http://www.democrats.reform.house.gov>].

<sup>74</sup> “U.S. Owes \$208 Million to Iraq, U.N. Audit Finds,” *Washington Post*, November 6, 2005.

<sup>75</sup> Among the most incisive are Anthony Cordesman, *Cleaning Up the Mess*, Center for Strategic and International Studies, July 7, 2004; David Rieff, “Blueprint for a Mess,” *New York Times Magazine*, November 2, 2003; George Packer, “War After War: Letter from Baghdad,” *The New Yorker*, November 24, 2003; Kenneth M. Pollack, “After Saddam: Assessing the Reconstruction of Iraq,” *Foreign Affairs*, January/February 2004; John Hamre and others, *Iraq’s Post-Conflict Reconstruction: A Field Review and Recommendations*, Center for Strategic and International Studies, July 17, 2003; James Fallows, “Blind into Baghdad,” *The Atlantic Monthly*, January/February 2004; Center for Strategic and International Studies, Post-Conflict Reconstruction Project, Frederick Barton and Bathsheba Crocker, Co-Directors, *Progress or Peril? Measuring Iraq’s Reconstruction*, September 2004 and November 12 Update; and Larry Diamond, *Squandered Victory: The American Occupation and the Bungled Effort to Bring Democracy to Iraq*, Henry Holt, 2005; James Fallows, “Why Iraq Has no Army,” *The Atlantic Monthly*, December 2005.

implementing reconstruction projects. The report then draws on these failures to inform its recommendations for the future, including the suggestion that staff with expertise in post-conflict situations be utilized and encouraged to serve in Iraq longer than six months; that Iraqis representing a range of views participate in design and implementation of U.S. reconstruction projects; that development of the Iraqi private sector be emphasized through greater use of Iraqis as subcontractors; and that prime contractors be required to employ Iraqis as much as possible.<sup>76</sup>

Another category of assessments are reviews of specific projects. Security concerns in Iraq have made difficult the kind of expert and anecdotal reports usually produced in other places by interest groups and the news media. Most project assessments, therefore, have come from the various government auditors. Even these, however, appear constrained by security in the number of site-visits they are able to undertake to review project results. One of four water projects assessed by the SIGIR in 2005 could not be visited due to security concerns, and the SIGIR is conducting some of its assessments by aerial imagery because of the risk to its personnel. GAO investigators were not even able to visit Iraq while preparing a recent report on water and sanitation programs.<sup>77</sup>

One problem with assessing the progress of reconstruction is that there is no “big picture” overview. Responsible government agencies provide information regarding how many infrastructure projects are being started and completed, how many small-scale grants are being provided, and how many people are being trained, but there is little detail regarding to what degree the overall national need for drinking water, sanitation, health care, electricity, and other requirements is being met by the billions of dollars in U.S. resources targeted at these needs.

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<sup>76</sup> International Crisis Group, *Reconstructing Iraq*, September 2, 2004. Available at [<http://www.crisisgroup.org/home/index.cfm?>].

<sup>77</sup> SIGIR, *Report to Congress*, July 30, 2005, p. 60-66. For an assessment of several aspects of reconstruction, see GAO, *Rebuilding Iraq: Status of Funding and Reconstruction Efforts*, GAO-05-876, July 2005. Also, GAO, *Rebuilding Iraq: U.S. Water and Sanitation Efforts Need Improved Measures for Assessing Impact and Sustained Resources for Maintaining Facilities*, GAO-05-872, September 2005.